

June 2019

Trust in water

Variation of Icosa Water Services Limited's appointment to include Lady Dane Farm, Faversham

1. About this document

Variation of Icosa Water Services Limited's appointment to include Lady Dane Farm

On 27 March 2019, Ofwat began a consultation on a proposal to vary Icosa Water Services Limited's ("**IWS**") [appointment to become the sewerage services provider for a development in Icosa Water Services Limited's ("**IWS**") sewerage services area called Lady Dane Farm in Faversham, Kent ("**the Site**").

The consultation ended on 25 April 2019. During the consultation period, we received representations from three organisations, which we considered in making our decision. On 24 May 2019, we granted a variation to its existing appointment to enable it to supply sewerage services to the Site.

This notice gives our reasons for making this variation.

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2. Introduction

The new appointment and variation (“**NAV**”) mechanism, specified by Parliament and set out in primary legislation, allows one company to replace the current company as the provider of sewerage services for a specific area. This mechanism can be used by new companies to enter the market and by existing companies to expand into areas where they are not the appointed company. In this case, IWS applied to replace SRN to become the appointed sewerage company for the site.

A company may apply for a variation of its existing appointment to serve an additional site if any of the following three criteria are met:

- None of the premises in the proposed area of appointment is served by the existing appointed company at the time the appointment is made (the “**unserved criterion**”);
- Each premises is likely to be supplied with at least 50 mega litres per year (in England) or at least 250 mega litres per year (in Wales) and the customer in relation to each premises consents (“**the large user criterion**”);
- The existing water and sewerage supplier in the area consents to the appointment (“**the consent criterion**”).

When considering applications for new appointments and variations, Ofwat operates within the statutory framework set out by Parliament, including our duty to protect consumers wherever appropriate, by promoting effective competition. In particular, in relation to unserved sites, we seek to ensure that the future customers on the site – who do not have a choice of supplier – are adequately protected. When assessing applications for new appointments and variations, the two key policy principles we apply are:

1. Customers, or future customers, should be no worse off than if they had been supplied by the existing appointee; and
2. We must be satisfied that an applicant will be able to finance the proper carrying out of its functions as a water and/or sewerage company.

Entry and expansion (and even the threat of such by potential competitors) can lead to benefits for different customers (such as household and business customers and developers of new housing sites). Benefits can include price discounts, better

services, environmental improvements and innovation in the way services are delivered.

Benefits can also accrue to customers who remain with the existing appointee, because when the existing appointee faces a challenge to its business, that challenge can act as a spur for it to improve its services. We believe the wider benefits of competition through the new appointments and variations mechanism can offset any potential disbenefits for existing customers that might arise. We consider these potential disbenefits in more detail below.

3. The application

IWS applied to be the sewerage services appointee for the site under the unserved criterion set out in section 7(4)(b) of the Water Industry Act 1991 (“**WIA91**”). IWS will serve the Site by way of a bulk discharge agreement with SRN, allowing it to discharge sewage from the Site into the sewers of SRN. .

3.1 Unserved status of the site

To qualify under the unserved criterion, an applicant must show that at the time the appointment is made, none of the premises in the proposed area of appointment is served by the existing appointee.

IWS has provided an independent report which confirms the Site is unserved.

Having reviewed the facts of this Site, and taking into account the independent report, we consider the Site to be unserved for sewerage.

3.2 Financial viability of the proposal

We will only make an appointment if we are satisfied that the proposal poses a low risk of being financially non-viable. We assess the risk of financial viability on a site-by-site basis and also consider the financial position of the company as a whole.

Based on the information available to us, we concluded the site demonstrates sufficient financial viability, and IWS has satisfied us that it can finance its functions and that it is able to properly carry them out.

3.3 Assessment of ‘no worse off’

IWS will offer charges equivalent to those of SRN.

With regard to service levels, we have reviewed IWS's Codes of Practice and its proposed service levels and compared these to the Codes of Practice and the performance commitments of SRN. Based on this review, we are satisfied that customers will be offered an appropriate level of service by IWS and that overall customers will be ‘no worse off’ being served by IWS instead of by SRN.

3.4 Effect of appointment on SRN's customers

In considering whether customers will be no worse off, we also looked at the potential effects of this variation on the price that SRN's existing customer base may face.

The calculation necessarily depends on a range of assumptions, and there are clearly difficulties involved in quantifying the effect on customers of SRN. It is therefore necessary to use a simplified set of figures. We have expressed the effect in 'per bill' terms to try and quantify the possible effect in an easily understandable way. Broadly, we have assessed the potential magnitude of this impact by comparing how much SRN might have expected to receive in revenue from serving the Site directly, were they to serve the Site, with the revenues they might expect from the proposed arrangement with IWS.

In this case, we have calculated that if we grant the site to IWS, there may be a potential minimal impact on the bills of SRN's existing customers of less than one penny.

This impact does not take into account the potential spillover benefits to customers arising from dynamic efficiencies achieved as a result of the competitive process to win new sites.

3.5 Developer choice

Where relevant, we take into consideration the choices of the site developer. In this case the developer, Crest Nicholson, said that it wanted IWS to be the sewerage company for the Site.

4. Responses received to the consultation

We received three responses to our consultation, namely from the Consumer Council for Water (“CCWater”), the Environment Agency (“EA”) and SRN. We considered these responses before making the decision to vary IWS' appointment. The points raised in the response are set out below.

4.1 CCWater

Overall, CCWater agrees with Ofwat's assessment that customers will be no worse off if served by IWS instead of SRN. CCWater accepts that given IWS' relatively small size and disparate nature of its customer base, it may be appropriate for IWS to tailor some of the services that it provides. Until it can provide a social tariff, CCWater stated that it would expect IWS to offer appropriate, flexible support to any individual customers in financial difficulty that would otherwise benefit from a social tariff. CCWater expects that this should not be at the expense of IWS' other customers.

CCWater noted that there would be a very low cost passed on to SRN's existing customers although it did not see that they would receive any significant benefit. CCWater also highlighted that it is disappointed that there is no direct financial benefit to customers on the Site as a result of having IWS as its water supply provider in that customers on the Site will not receive a discount.

Our response

One of Ofwat's key NAV policies is that customers should be 'no worse off' if a NAV is granted. In other words, an applicant must ensure its new customers are made no worse off in terms of price and service than if they had been served by the previous incumbent. This requirement has been met by IWS in its proposal to improve the levels of service and match the pricing set by SRN. We do not require applicants to offer a better service and price than the previous incumbent.

4.2 EA

The EA responded, indicating that it has no objection, but noting that there should be no occupation of properties until the necessary downstream improvements to infrastructure have been made, and that additional flows from the development should not lead to a deterioration on the performance of SRN's downstream sewerage assets.

Our response

SRN has provided confirmation to IWS that there is sufficient capacity to take the discharge profiled at the Site. The requirement set by the EA has therefore been met.

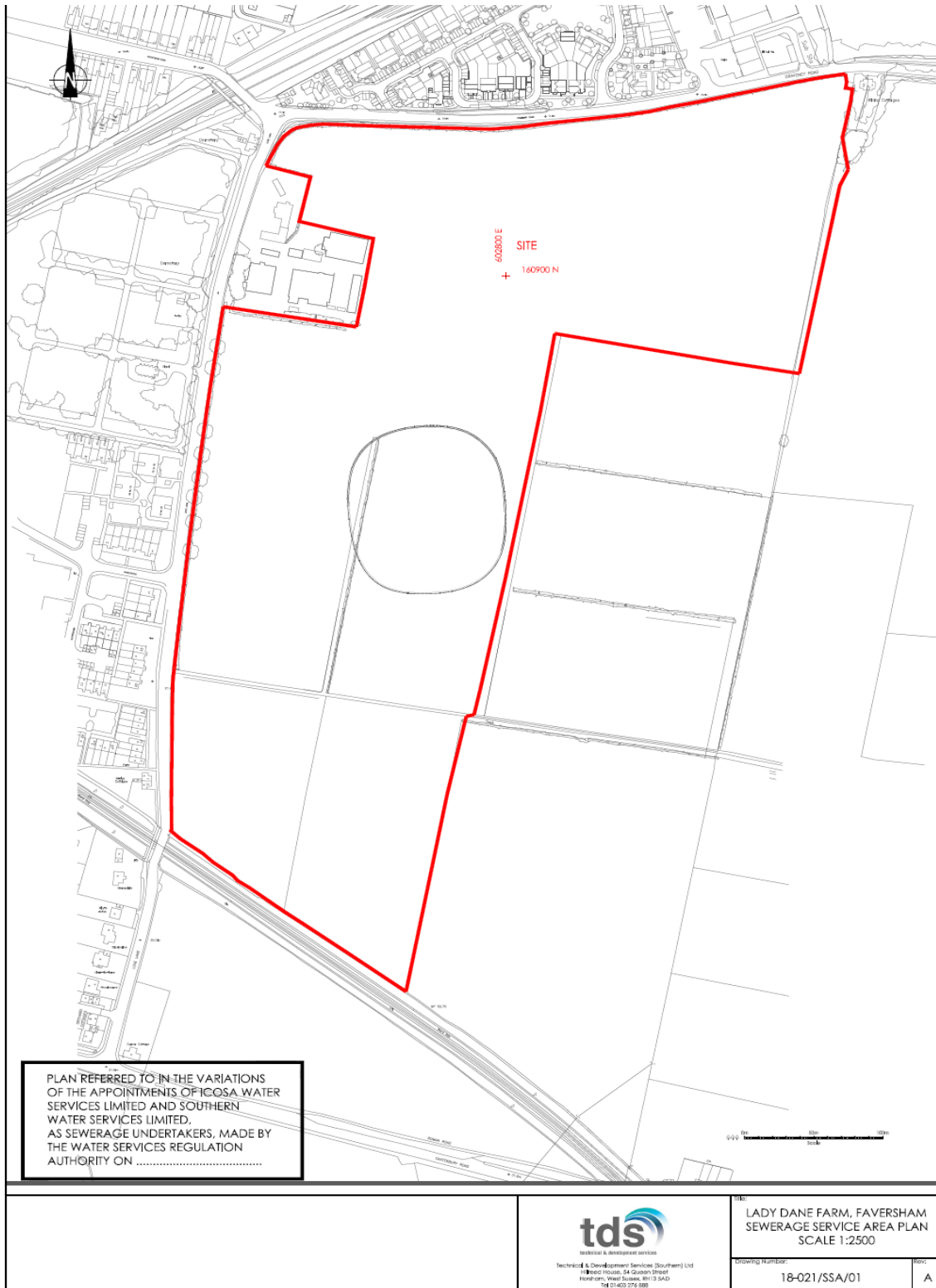
4.3 SRN

SRN confirmed that it had no further representations to make in response to our consultation

5. Conclusion

Having assessed IWS's application, and having taken account of the responses we received to our consultation, we decided to grant a variation to IWS's area of appointment to allow it to serve the site for sewerage services. This appointment became effective on 27 May 2019.

Appendix 1: Site Map



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